

paragraph (f)(2) of this section) for the production. Examples of indirect payments paid or incurred on the owner's behalf are payments by a partner on behalf of an owner that is a partnership, payments by a shareholder on behalf of an owner that is a corporation, and payments by a contract producer on behalf of the owner. Payments for services are all elements of compensation as provided for in §§1.263A-1(e)(2)(i)(B) and (e)(3)(ii)(D). Compensation is not limited to wages reported on Form W-2, "Wage and Tax Statement," and includes compensation paid or incurred to independent contractors. However, solely for purposes of paragraph (a) of this section, the term "compensation" does not include participations and residuals (as defined in section 167(g)(7)(B)). See §1.181-1(a)(3) for additional rules concerning participations and residuals.

(d) *Qualified compensation.* The term *qualified compensation* means, for purposes of this section and §1.181-2(c)(2), all compensation (as defined in paragraph (c) of this section) paid or incurred for services performed in the United States (as defined in paragraph (f)(3) of this section) by actors, directors, producers, and other production personnel for the production. A service is performed in the United States for purposes of this paragraph (d) if the principal photography to which the compensated service relates occurs within the United States and the person performing the service is physically present in the United States. For purposes of an animated film or animated television production, the location where production activities such as keyframe animation, in-between animation, animation photography, and the recording of voice acting performances are performed is considered in lieu of the location of principal photography. For purposes of a production incorporating both live action and animation, the location where production activities such as keyframe animation, in-between animation, animation photography, and the recording of voice acting performances for the production is considered in addition to the location of principal photography.

(e) *Special rule for acquired productions.* A person who acquires a produc-

tion from a prior owner must take into account all compensation paid or incurred by or on behalf of the seller and any previous owners in determining if the production is a qualified film or television production as defined in paragraph (a) of this section. Any owner that elects to deduct as production costs the costs of acquiring a production and any subsequent production costs must obtain from the seller detailed records concerning the compensation paid or incurred for the production and, for a pre-amendment production, concerning aggregate production costs, in order to demonstrate the eligibility of the production under section 181.

(f) *Other definitions.* The following definitions apply for purposes of this section and §§1.181-1, 1.181-2, 1.181-4, 1.181-5, and 1.181-6:

(1) *Actors.* The term *actors* means players, newscasters, or any other persons who are compensated for their performance or appearance in a production.

(2) *Production personnel.* The term *production personnel* means persons who are compensated for providing services directly related to the production, such as writers, choreographers, composers, casting agents, camera operators, set designers, lighting technicians, and make-up artists.

(3) *United States.* The term *United States* means the 50 states, the District of Columbia, the territorial waters of the continental United States, the airspace or space over the continental United States and its territorial waters, and the seabed and subsoil of those submarine areas that are adjacent to the territorial waters of the continental United States and over which the United States has exclusive rights, in accordance with international law, for the exploration and exploitation of natural resources. The term "United States" does not include possessions and territories of the United States (or the airspace or space over these areas).

[T.D. 9551, 76 FR 60727, Sept. 30, 2011]

§ 1.181-4 Special rules.

(a) *Recapture—(1) Applicability—(i) In general.* The requirements of this paragraph (a) apply notwithstanding

whether an owner has satisfied the revocation requirements of § 1.181-2(d). An owner that claimed a deduction under section 181 for a production in any taxable year in an amount in excess of the amount that would be allowable as a deduction for that year in the absence of section 181 must recapture the excess amount as provided for in paragraph (a)(3) of this section for the production in the first taxable year for which—

(A) For any pre-amendment production, the aggregate production costs of the production exceed the applicable aggregate production costs limit under § 1.181-1(b)(1)(i) or (b)(2);

(B) For any pre-amendment production, the owner no longer reasonably expects (based on all of the facts and circumstances at the end of the current taxable year) that the aggregate production costs of the production will not, at any time, exceed the applicable aggregate production costs limit set forth under § 1.181-1(b)(1)(i) or (b)(2);

(C) The owner no longer reasonably expects (based on all of the facts and circumstances at the end of the current taxable year) either that the production will be set for production or that the production will be a qualified film or television production; or

(D) The owner revokes the election pursuant to § 1.181-2(d).

(ii) *Special rule.* An owner that claimed a deduction under section 181 and disposes of the production prior to its initial release or broadcast must recapture the entire amount specified under paragraph (a)(3) of this section in the year the owner disposes of the production before computing gain or loss from the disposition.

(2) *Principal photography not commencing prior to the date of expiration of section 181.* If an owner claims a deduction under section 181 for a production for which principal photography does not commence prior to the date of expiration of section 181, the owner must recapture deductions as provided for in paragraph (a)(3) of this section in the owner's taxable year that includes the date of expiration of section 181.

(3) *Amount of recapture.* An owner subject to the recapture requirements under this section must, for the taxable year in which recapture is re-

quired, include in the owner's gross income as ordinary income and add to the owner's adjusted basis in the property—

(i) For a production that is placed in service in a taxable year prior to the taxable year for which recapture is required, the difference between the aggregate amount the owner claimed as a deduction under section 181 for the production for all such prior taxable years and the aggregate depreciation deductions that would have been allowable for the production for such prior taxable years (or that the owner could have elected to deduct in the taxable year that the production was placed in service) for the production under the owner's method of accounting; or

(ii) For a production that has not been placed in service, the aggregate amount claimed as a deduction under section 181 for the production for all such prior taxable years.

(b) *Recapture under section 1245.* For purposes of recapture under section 1245, any deduction allowed under section 181 is treated as a deduction allowable for amortization.

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§ 1.181-5 Examples.

The following examples illustrate the application of §§ 1.181-1 through 1.181-4:

Example 1. X, a corporation that uses an accrual method of accounting and files Federal income tax returns on a calendar-year basis, is a producer of films. X is the owner (within the meaning of § 1.181-1(a)(2)) of film ABC. X incurs production costs in year 1, but does not commence principal photography for film ABC until year 2. In year 1, X reasonably expects, based on all of the facts and circumstances, that film ABC will be set for production and will be a qualified film or television production. Provided that X satisfies all other requirements of §§ 1.181-1 through 1.181-4 and § 1.181-6, X may deduct in year 1 the production costs for film ABC that X incurred in year 1.

Example 2. The facts are the same as in *Example 1*. In year 2, X begins, but does not complete, principal photography for film ABC. Most of the scenes that X films in year 2 are shot outside the United States and, as of December 31, year 2, less than 75 percent of the total compensation paid for film ABC is qualified compensation. Nevertheless, X still reasonably expects, based on all of the facts and circumstances, that film ABC will be a qualified film or television production.